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210618Z Aug 03

UNCLAS HARARE 001652

SIPDIS

STATE FOR AF/S
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
USDOC FOR 2037 DIEMOND
TREASURY FOR OREN WYCHE-SHAW
PASS USTR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

¶E. O. 12958: N/A
TAGS: ECON EINV PGOV ZI
SUBJECT: Inflation 400 Percent; Zimdollar 5,000:1

¶1. Summary: Year-on-year inflation has reached 400 (actually 399.5) percent while the Zimdollar has fallen to Z$5,000:US$. The Government still seems unwilling to let the market (or an independent central bank) determine interest or exchange rates. As a result of this strained macroeconomic environment, the business outlook remains poor. End Summary.

Spiraling Inflation

¶2. Still, Zimbabwe's cash shortage may be subduing inflation by suppressing consumer demand for certain non-essentials. Handicraft and apparel manufacturers have recently told us the cash crisis is slowing domestic sales.

¶3. Price controls have failed to contain inflation and industry now ignores most of them. To some extent, the GOZ has conceded this by recasting its role to monitor rather than control prices.

¶4. We do not believe the Government will be able to rein in inflation without allowing interest rates (currently over 300 percent negative) to rise. Since nearly all personal and business loans carry variable rates, this will be painful medicine and spark defaults en masse. Several local banks could go under. Most importantly, negative real interest rates are failing to spur growth, their only compelling rationale (other than the GOZ's desire to borrow cheaply).

Rapidly Devaluing Zimdollar

¶5. The weakening Zimdollar is the most obvious symptom of dismal external accounts. In this regard, negative interest rates are driving capital out of the country, while the country's shaky politics and judiciary eliminate any possibility of attracting new foreign direct investment (FDI). At the same time, the overvalued official exchange rate enforced by the Reserve Bank means exporters cannot take advantage of Zimbabwe's low opportunity costs in many sectors. Furthermore, the GOZ forces many firms (e.g., cotton, fertilizer, maize, coal, etc.) to sell part of their production locally rather than abroad, making them settle for less favorable cost ratios. Since 2001, imports have exceeded exports.

¶6. Finally, given its arrears, the GOZ is unable to reengage multilateral lending organizations like the International Monetary Fund and World Bank. Other than shoring up FDI and exports, this would be the easiest short-term solution to make up the external accounts shortfall.

Comment

¶7. Although statistics are unreliable in this area, the current account deficit alone may now be 8 percent of GDP. (The IMF estimated it at 6.7 percent in December 2002.) Zimbabwe's position in a world economy is slipping fast.

Sullivan